Price Caps

On September 19, 1990, the FCC adopted "price cap" regulation as a replacement for traditional rate of return regulation for LECs, such as the Company. The new system places a cap on overall prices for interstate services and requires that the cap decrease annually, in inflation-adjusted terms, by a fixed amount which is intended to reflect expected increases in productivity. The price cap level can also be adjusted to reflect "exogenous" changes, such as changes in FCC separations or accounting rules. LECs subject to price caps have somewhat increased flexibility to change the prices of existing services within certain groupings of interstate services, known as "baskets".

Under price cap regulation, the Company can earn a rate of return on overall investment of up to 12.25% (100 basis points over the currently authorized rate of return of 11.25%). If the Company's rate of return is between 100 and 500 basis points above the authorized rate of return (that is, currently, between 12.25% and 16.25%), the Company must share 50% of the earnings above the 100-basis-point level with customers by reducing rates prospectively. All earnings above the 500-basis-point level must be returned to customers in the form of prospective rate decreases. If, on the other hand, the Company's rate of return is more than 100 basis points below the authorized rate of return (that is, currently, below 10.25%), the Company is permitted to increase rates prospectively to make up the deficiency.

LEC price cap regulation took effect on January 1, 1991. The LEC price cap order has been appealed by several parties to the United States Court of Appeals for the District of Columbia Circuit. These appeals are being held in abeyance pending the FCC's resolution of pending petitions for reconsideration. Pending a decision on these appeals, which is unlikely to occur within the next year, price cap regulation remains in effect for the Company.

Computer Inquiry III

In August 1985, the FCC initiated Computer Inquiry III to reexamine its regulations requiring that "enhanced services" (e.g., voice messaging services, electronic mail, videotext gateway, protocol conversion) be offered only through a structurally separated subsidiary. In 1986, the FCC eliminated this requirement, permitting the Company to offer enhanced services, subject to compliance with a series of nonstructural safeguards designed to promote an effectively competitive market. These safeguards include detailed cost accounting, protection of customer information and certain reporting requirements.

In June 1990, the United States Court of Appeals for the Ninth Circuit vacated and remanded the Computer Inquiry III decisions, finding that the FCC had not fully justified those decisions. On December 20, 1991, the FCC adopted an order on remand which reinstated structural relief upon a company's compliance with the FCC's Computer Inquiry III Open Network Architecture (ONA) requirements, and strengthened some of the nonstructural safeguards. In the interim, the Company had filed an interstate tariff implementing the ONA requirements. That tariff became effective on February 2, 1992, subject to further investigation. On March 9, 1992, the Company certified to the FCC that it had complied with all initial ONA obligations and should be granted structural relief for enhanced services. The FCC is expected to rule on that certification during the second quarter of 1992.

The FCC's December 1991 order has been appealed to various United States Courts of Appeals by several parties. Pending decisions on those appeals, which are not expected to occur before 1993, the FCC's decision remains in effect. If the Court again reverses the FCC, the Company's right to offer enhanced services could be impaired.

FCC Cost Allocation Rules

In 1987, the FCC adopted rules governing (1) the allocation of costs between regulated and nonregulated activities and (2) transactions with affiliates. Pursuant to those rules, the Company has filed a cost allocation manual which has been approved by the FCC.

The cost allocation rules apply to activities that have never been regulated as communications common carrier offerings and to activities that have been pre-emptively deregulated by the FCC. The costs of these activities are removed prior to the separations process and are allocated to non-regulated activities in the aggregate, not to specific services for pricing purposes. Other activities must be accounted for as regulated activities, and their costs will be subject to the separations process. These include (1) activities which have been deregulated by the FCC without pre-empting state regulation, (2) activities which have been deregulated by the state but not the FCC and (3) "incidental activities," which cannot, in the aggregate, produce more than 1% of a company's revenues.

The affiliate transaction rules generally require that assets be transferred between affiliates at market price, if such price can be established through a tariff or prevailing price charged to third parties. In the absence of such information, transfers from a regulated to an unregulated affiliate must be valued at the higher of cost or fair market value, and transfers from an unregulated to a regulated affiliate must be valued at the lower of cost or fair market value. Services provided to an affiliate must be valued at tariff rates, or market prices if the service is also provided to unaffiliated entities. If the affiliate does not also provide the service to unaffiliated entities, the price must be determined in accordance with the FCC's cost allocation principles.

The FCC has not made its rules pre-emptive. State regulatory authorities are free to use different cost allocation methods and affiliate transaction rules for intrastate ratemaking, and to require carriers to keep separate allocation records.

Telephone Company/Cable Television Cross-Ownership

In 1987, the FCC initiated an inquiry into whether developments in the cable and telephone industries warranted changes in the "cross-ownership" rules prohibiting telephone companies such as the Company from providing cable service in their service territories directly or indirectly through an affiliate.

On November 22, 1991, the FCC released a Further Notice of Proposed Rulemaking (FNPRM) in its cross-ownership proceedings. The FNPRM proposed to permit telephone companies such as the Company to provide video dial tone service on a common carrier basis.

The FCC also released a First Report and Order (Order) and a Second Further Notice of Inquiry (FNOI). In the Order, the FCC ruled that neither telephone companies that provide video dial tone service, nor video programmers that use these services, are required to obtain local cable franchises. The FNOI asks for comments on whether the FCC should recommend to Congress any changes in the statute prohibiting telephone companies from providing cable service in their telephone service areas.

Interconnection and Collocation

On June 6, 1991, the FCC released a Notice of Proposed Rulemaking (NPRM) which proposes to allow third parties to collocate their equipment in, or very near, telephone company offices to provide special access (private line) services to the public. The FCC's stated purpose for the proposed rulemaking is to encourage greater competition in the provision of interstate special access services. The FCC has tentatively concluded that collocating parties would pay the telephone company an interconnection charge that is lower than the existing tariffed rates for similar non-collocated services. In the same release, the FCC issued a Notice of Inquiry (NOI) asking what policies it should adopt in regard to interstate switched access collocation. Comments and replies to the NPRM and NOI have been filed by the Bell Atlantic telephone companies and others. The FCC has not reached a final decision in either part of the proceeding, nor can the Company predict when such a decision will be made.

If the FCC permits increased competition by allowing collocation, the Company's revenue would be adversely affected, although some of the lost revenue could be offset by increased demand if, as the Bell Atlantic telephone companies requested in their comments, the FCC provides the Company with greater pricing flexibility. Collocation for the provision of switched access services would result in greater revenue losses to the Company than would special access collocation. The Company will not be able to estimate the revenue impact of either type of collocation until the condition of collocation (if any) are determined and announced by the FCC.

Intelligent Networks

On December 6, 1991, the FCC issued a NOI into the plans of exchange carriers, including the Company, to deploy new "modular" network architectures, such as Advanced Intelligent Network (AIN) technology. The NOI asks what, if any, regulatory action the FCC should take to assure that such architectures are deployed in a manner that is "open, responsive, and procompetitive". The FCC is still accepting comments on this NOI, and the Company cannot predict when the FCC will issue an order in this proceeding.

The result of this inquiry could include a requirement that the Company offer individual components of its services, such as switching and transport, to competitors who will provide the remainder of such services through their own facilities. Such increased competition could divert revenues from the Company. However, deployment of AIN technology may also enable the Company to respond more quickly and efficiently to customer requests for new services. This could result in increased revenues from new services that could partially offset the expected competitive losses.

STATE REGULATION AND INTRASTATE RATES

The communications services of the Company are subject to regulation by the PUC with respect to intrastate rates and services, intrastate depreciation rates and other matters. Approximately 75 percent of the Company's revenues are derived from services regulated by the PUC. The Company continues to operate under traditional rate of return regulation for its regulated intrastate services. However, legislation has been introduced in the Pennsylvania Assembly to grant the PUC authority to implement regulatory modifications. One bill would require local telephone companies to undertake a program of accelerated deployment of broadband technology in return for the optional removal of competitive services from commission oversight and an inflation adjusted rate stability plan for all other services. Except where otherwise directed by the PUC, the Company follows FCC rules regarding accounting principles, jurisdictional separations procedures, cost allocations and affiliate transactions in determining intrastate financial results.

In March 1988, the Pennsylvania Attorney General and the Office of Consumer Advocate filed complaints in the Commonwealth Court and with the PUC, respectively, alleging that the Company had engaged in overselling of certain optional telephone services in violation of the Consumer Protection Law and the Public Utility Code. On April 10, 1990, the parties filed agreements in the Commonwealth Court and with the PUC to settle these complaints. The agreement filed with the PUC was approved by the PUC on June 14, 1990; the agreement filed in the Commonwealth Court did not require Commonwealth Court approval. Pursuant to the settlement agreements, the Company, during the period from July 1990 through March 1991, credited or refunded approximately $1.2 million under the Attorney General complaint settlement and approximately $26.4 million under the Office of Consumer Advocate complaint settlement to residential customers who subscribed to or began to receive certain optional services during designated periods. The Company also made a payment of $450,000 to cover the Attorney General's legal expenses in prosecuting its complaint. In April 1991, the Company provided an additional credit of approximately $8.8 million to certain residential customers under the Office of Consumer Advocate complaint settlement. The Company also agreed, under both settlements, to continue modifications it had previously made to its optional services sales practices and agreed in the Office of Consumer Advocate complaint settlement to contribute $5.0 million (including $1.0 million in Company-supplied products and services) over a five-year period to fund a telecommunications consumer education fund.

Depreciation

On December 19, 1991, the PUC approved the Company's petition to change the depreciable lives of certain classes of plant resulting in a net decrease to plant lives. The effect of the PUC award will increase 1992 intrastate annual depreciation expense approximately $70.0 million.

NEW PRODUCTS AND SERVICES

Bell Atlantic® I.Q.℠ Services

The Company has introduced or is in the process of introducing several of the Bell Atlantic® I.Q.℠ Services family of calling features. These features include Identa Ring℠ service, which allows a single line to have multiple telephone numbers, each with a distinctive ring; Repeat Call, which allows customers automatically to redial busy phone numbers; and Return Call, which allows customers automatically to return the last incoming call, even without knowing the number.

Other services being tested by the Company include Ultra Forward℠, which customers can use to program call-forwarding instructions, and Home Intercom, which allows for phone-to-phone dialing within the home.

Gateway Services

The Company is continuing its service trials for Gateway Services, which provide a single point of entry for users of personal computers to gain access to multiple databases.

Information Services

The Company offers various types of information services, such as message storage services, voice mail, electronic mail, and electronic data interexchange (see "Line of Business Restrictions"). The Company also offers Answer Call, a telephone answering service aimed at residential and small business customers.

COMPETITION

Regulatory rulings, as well as new technology, are continuing to expand the types of available communications services and equipment and the number of competitors offering such services. Increasingly, competitors are large companies with substantial capital, technological and marketing resources.

Bypass

A substantial portion of the Company's revenues from business and government customers is derived from a relatively small number of large, multiple-line subscribers.

The Company faces competition from alternative communications systems, constructed by large subscribers or by interexchange carriers, which originate and/or terminate calls without using the local telephone company's plant. Metropolitan Fiber Systems has deployed an optical fiber network which competes with the Company in the Philadelphia and Pittsburgh metropolitan areas. Another company has deployed an optical fiber network in the Philadelphia area, and a third company is constructing an optical fiber network in the Pittsburgh metropolitan area.

Metropolitan Fiber Systems has filed petitions with the FCC and the Department of Justice as well as the Pennsylvania PUC and the Maryland Public Service Commission, seeking to require additional forms of interconnection with telephone company facilities to enhance their competitive efforts.

Other potential sources of competition are cable television systems, shared tenant services and other non-carrier systems which are capable of bypassing the Company's local plant either completely, or partially, through substitution of special access for switched access or through concentration of telecommunications traffic on fewer of the Company's lines.

To meet this competition, the Company has maintained competitive cost-based prices for exchange access (to the extent the FCC and PUC permit the Company's prices to move toward costs), kept service quality high and effectively implemented new technology (see "FCC Regulation and Interstate Rates - Interstate Access Charges" and "FCC Access Charge Pooling Arrangements").

Personal Communications Services

Radio-based personal communications services also constitute potential sources of competition to the Company. The FCC has authorized trials of such services, using a variety of technologies, by numerous companies. On January 16, 1992, the FCC adopted a NPRM to allocate a portion of the spectrum to emerging telecommunications technologies, including Personal Communications Services (PCS). PCS consists of a series of wireless portable telephone services which would allow customers to make and receive calls from any location using small handsets. If implemented, PCS and other similar services would compete with services currently offered by the Company, potentially resulting in revenue losses to the Company. However, the Company may derive new revenues if it is authorized to provide PCS or similar new services. If PCS is implemented, the FCC is expected to authorize more than a single service provider in each geographic area.

Centrex

The Company offers Centrex service, which is a central office-based communications system for business, government and other institutional customers. Centrex service consists of a variety of integrated software-based features located in a centralized switch or switches and extended to the customer's premises primarily via local distribution facilities. Centrex has encountered continuing competition from CPE systems, such as private branch exchanges (PBXs), which perform similar functions with less use of the Company's switching facilities.

Users of Centrex systems generally require more subscriber lines than users of PBX systems of similar capacity. The FCC increased the maximum Subscriber Line Charge on embedded Centrex lines to $6.00, effective April 1, 1989. Increases in Subscriber Line Charges result in Centrex users incurring higher charges than users of comparable PBX systems. The PUC has permitted flexible pricing for certain Centrex services, which helps to offset the effects of such higher Subscriber Line Charges.

IntraLATA Competition

The ability of interexchange carriers to engage in the provision of intrastate intraLATA toll service in competition with the Company is subject to regulation by the PUC.

Directory

The Company's directory operations continue to face significant competition from other providers of directories, as well as competition from other advertising media. In particular, the former sales representative of the Company publishes competitive directories.

Coin Telephone Service

The Company faces increasing competition from alternate coin telephone service providers, cellular and potential PCS providers.

Operator Services

Alternative operator services providers have entered into competition with the Company's operator services product line.

CERTAIN CONTRACTS AND RELATIONSHIPS

The Company is a party to various arrangements for provisions to the Company of management advisory services and of technical research and development.

Certain planning, marketing, procurement, financial, legal, accounting, technical support and other management services are provided for the Company on a centralized basis through Bell Atlantic Network Services, Inc. (NSI), a service subsidiary of Bell Atlantic. Bell Atlantic Network Funding Corporation provides financing services to the Company. Prior to 1990, the Company shared the expenses of joint officers and employees with The Diamond State Telephone Company, another wholly-owned subsidiary of Bell Atlantic.

The seven RHCs each own (directly or through subsidiaries) a one-seventh interest in Bell Communications Research, Inc. (Bellcore). Pursuant to the Plan, this organization furnishes the RHCs and their BOC subsidiaries with technical assistance such as network planning and engineering, and software development, as well as various other consulting services that can be provided more effectively on a centralized basis. Bellcore is the central point of contact for coordinating the efforts of the RHCs in meeting the national security and emergency preparedness requirements of the federal government. It also helps to mobilize the combined resources of the companies in times of natural disasters.

EMPLOYEE RELATIONS

As of December 31, 1991, the Company employed approximately 16,200 persons representing a 1.5% decrease from the number of employees at December 31, 1990. The Company's workforce is augmented by members of the centralized staff of NSI, who perform services for the Company on a contract basis.

Approximately 86% of the employees of the Company are represented by unions. Of those so represented, approximately 87% are represented by the Communications Workers of America, which is affiliated with the AFL-CIO and approximately 13% are represented by the International Brotherhood of Electrical Workers which is also affiliated with the AFL-CIO.

Under the terms of the three-year contracts ratified in September 1989 by unions representing associate employees, represented associates received a base wage increase of 2.25% and a cost of living increase of 1.15% in August 1991. Under the same contracts, associates received a Corporate Profit Sharing payment of $480 per person in 1992 based on the Company's 1991 financial performance.

Item 2. Properties

The principal properties of the Company do not lend themselves to simple description by character and location. At December 31, 1991, the Company's investment in plant, property and equipment consisted of the following:

Connecting lines	46%
Central office equipment	35
Land and buildings	8
Telephone instruments and related equipment	1
Other	10
	100%

"Connecting lines" consists primarily of aerial cable, underground cable, poles, conduit and wiring. "Central office equipment" consists of switching equipment, transmission equipment and related facilities. "Land and buildings" consists of land owned in fee and improvements thereto, principally central office buildings. "Telephone instruments and related equipment" consists primarily of public telephone terminal equipment and other terminal equipment. "Other" property consists primarily of furniture, office equipment, vehicles and other work equipment, capital leases, leasehold improvements and plant under construction.

At December 31, 1991 and 1990, essentially all of the Company's central offices are being served by electronic switching equipment.

An analysis of the estimated components of the Company's construction program for the last two years is as follows:

	(In Millions)	
	1991	1990
Network growth	$309	$305
Network support	125	108
Network modernization	79	101
Network replacement	50	49
Market specific	46	50
Operations support	21	13
	630	626
Allowance for funds used during construction	1	3
Total construction program ..	$631	$629

Item 3. Legal Proceedings

Pre-Divestiture Contingent Liabilities

The Plan provides for the recognition and payment by AT&T and the former BOCs (including the Company) of liabilities that are attributable to pre-Divestiture events but do not become certain until after Divestiture. These contingent liabilities relate principally to litigation and other claims with respect to the former Bell System's rates, taxes, contracts, and torts (including business torts, such as alleged violations of the antitrust laws). Except to the extent that affected parties otherwise agree, contingent liabilities that are attributable to pre-Divestiture events are shared by AT&T and the BOCs in accordance with formulas prescribed by the Plan, whether or not an entity was a party to the proceeding and regardless of whether an entity was dismissed from the proceeding by virtue of settlement or otherwise. Each company's allocable share of liability under these formulas depends on several factors, including the type of contingent liability involved and each company's relative net investment as of the effective date of Divestiture. Under the formula generally applicable to most of the categories of these contingent liabilities, the Company's aggregate allocable share of liability is approximately 3.0%.

The Company's share of these liabilities to date has not been material to its financial position or results of operations for any period. While complete assurance cannot be given as to the outcome of any contingent liabilities, in the opinion of the Company's management, any monetary liability or financial impact to which the Company is subject as a result of these contingent liabilities is not expected to be material in amount to the financial position of the Company.

Pending Cases

AT&T and various of its subsidiaries and the BOCs (including in some cases the Company) have been parties to various types of litigation, including litigation involving allegations of violations of antitrust laws and equal employment laws. Most of the litigation alleging violations of the antitrust laws has been resolved. However, other matters are still pending. Damages, if any, ultimately awarded in these remaining actions relating to pre-Divestiture events could have a financial impact on the Company whether or not the Company is a defendant since such damages will be treated as contingent liabilities and allocated in accordance with the allocation rules established by the Plan (see "Pre-Divestiture Contingent Liabilities" above).

While complete assurance cannot be given as to the outcome of any litigation, in the opinion of the Company's management, any monetary liability or financial impact to which the Company would be subject after final adjudication of all of the foregoing actions would not be material in amount to the financial position of the Company.

Item 4. Submission of Matters to a Vote of Security Holders. (Omitted pursuant to General Instruction J(2).)

PART II

Item 5. Market for the Registrant's Common Equity and Related Stockholder Matters. (Inapplicable.)

Item 6. Selected Financial Data. (Omitted pursuant to General Instruction J(2).)

Item 7. Management's Discussion and Analysis of Results of Operations (Abbreviated pursuant to General Instruction J(2))

This discussion should be read in conjunction with the Financial Statements and Notes to Financial Statements as listed in the index set forth on page F-1.

NET INCOME

The Company experienced a loss of $24.0 million during 1991. The loss was primarily due to the Company's election to adopt Statement of Financial Accounting Standards No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions," (Statement No. 106) effective January 1, 1991 **(See Note 6 of Notes to Financial Statements). In conjunction with this adoption, the Company recorded a one-time, non-cash, after-tax charge of $397.3 million representing the actuarial liability for postretirement health and life insurance benefits, attributable to prior service of retired and active employees.** Excluding this item, net income for the year ended 1991 decreased $4.0 million from 1990. These results include charges related to a retirement incentive program and restructure initiatives implemented in 1991 and the ongoing benefit costs associated with the adoption of Statement No. 106 which reduced 1991 earnings. The rates of return on average total capital and to average common equity were 3.1% and (1.2%) in 1991 and 12.2% and 16.1% in 1990, respectively. The rates of return on average total capital and to average common equity, excluding the cumulative effect of the change in accounting principle, were 12.4% and 18.8% in 1991.

OPERATING REVENUES

Operating revenues increased $26.3 million over 1990. The increase in total operating revenues was comprised of the following:

	Increase (Decrease) (Dollars in Millions)
Local service	$ 28.8
Network access	(47.0)
Toll service	10.9
Directory advertising and other	33.6
	$ 26.3

Local Service

Local service revenues are earned from the provision of local exchange, local private line and public telephone services. Local service revenues increased $28.8 million during 1991. The increase resulted from the State Tax Adjustment Surcharge (STAS) which increased 1991 revenues $20.8 million. The STAS represents the recovery of tax increases resulting from legislation enacted by the Commonwealth of Pennsylvania. The Pennsylvania Public Utility Commission (PUC) allows the Company to recover a significant

portion of these increases in the form of a surcharge applied to customers' bills. The STAS affects each of the major revenue categories with the largest impact on local service. The Company also experienced access line growth of 71,300 lines or 1.4% in 1991. The growth in access lines and continued growth in demand for Intelligent Network features such as Custom Calling and Touchtone service increased revenues approximately $20.7 million during 1991; however, the rate of growth in access lines continues to be adversely affected by weak economic conditions. The comparable growth in access lines was 133,600 lines or 2.6% in 1990. These increases were partially offset by a $12.7 million revenue increase in 1990 due to the net impact of two transactions ordered by the PUC. In 1990, the Company retroactively collected $24.1 million for disallowed employee discount costs and refunded $11.4 million for the settlement of sales complaints.

Network Access

Network access revenues (switched, special and end-user) are earned from interexchange carriers (IXCs) for the use of the Company's local exchange facilities in providing interstate and intrastate long-distance services to their customers and from end-user subscribers. Switched access revenues are derived from usage based charges paid by IXCs for access to the Company's network. Special access revenues arise from access charges paid by subscribers who have private lines, and end-user revenues are earned from local exchange carrier customers who pay a flat monthly charge, per access line, for access to the network.

Effective January 1, 1991, the Federal Communications Commission (FCC) adopted price cap regulation and lowered the authorized rate of return for interstate services from 12.0% to 11.25%. Price caps, a form of incentive regulation, limit prices rather than profits. The FCC's price cap plan includes a sharing provision whereby interstate earnings above certain thresholds are shared equally with customers, while earnings above substantially higher thresholds are returned entirely to customers. Sharing occurs in the form of temporary prospective rate decreases. The Company reduced its rates for interstate access services on January 1, 1991 to reflect the lower authorized rate of return. In its first Annual Price Cap Tariff filing, effective July 1, 1991, the Company further reduced rates. These two rate reductions, net of a lower support obligation to the National Exchange Carrier Association interstate access revenue pool, reduced 1991 access revenues approximately $12.3 million.

The primary reason for the $47.0 million decline in network access revenues is a $40.2 million increase in revenues recorded in 1990 resulting from revised estimates of switched access revenue liabilities. Switched access revenues also decreased due to rate reductions resulting from the lowered authorized rate of return, as discussed in the previous paragraph. These decreases more than offset the 3.5% increase in switched access minutes of use. Special access revenues decreased $7.5 million or 6.2% during 1991 due in part to the rate reductions cited above. Special access revenues have also been adversely affected by competition and slow economic conditions. End-user revenues increased $6.0 million or 2.8% due primarily to changes in subscriber line charges. Moderate access line growth also contributed to the increase in end-user revenues.

Toll Service

Toll service revenues are earned from interexchange usage services such as Message Toll Services (MTS), Wide Area Telecommunications Services (WATS), and Corridor Services (between Southeastern Pennsylvania and Southern New Jersey). Toll service revenues increased $10.9 million, including $7.8 million for STAS. The remaining increase was volume related. A 6.2% increase in MTS volume more than offset a decrease in WATS and private line revenues due to increased competition for these services.

Directory Advertising and Other

Directory advertising and other includes revenues from the sale of advertising in the Company's telephone directories, billing and collection services provided to IXCs and others, premises services such as inside wire installation and maintenance services, rent of Company facilities by affiliates and non-affiliates, and the provision for uncollectibles.

Directory advertising and other increased $33.6 million primarily as a result of increased rental income of $23.8 million. This increase was due to higher charges to affiliated companies for use of the Company's facilities and the classification, as revenue, of a portion of the intercompany charges which had previously been reflected as a reduction of expense. Directory advertising revenues increased $14.5 million due to higher advertising rates, while volume growth has slowed due to the weakened economy and competition. Premises services revenue increased $8.2 million mainly due to repricing of the optional wire maintenance plans. These increases were offset by a $9.3 million reduction in billing and collection revenues due to reductions in the rates charged and the range of services provided to certain IXCs under the provisions of the long-term contracts negotiated in July 1990. The provision for uncollectibles increased $3.2 million to provide for uncollectibles associated with the increased revenues and the weakened economic conditions.

OPERATING EXPENSES

Operating expenses increased $39.6 million or 1.7% over 1990. The increase in total operating expenses was comprised of the following:

	Increase (Decrease) (Dollars in Millions)
Employee costs	$ 41.8
Depreciation and amortization	(50.3)
Other	48.1
	$ 39.6

Employee Costs

Employee costs consist primarily of salaries and wages, employee benefits and payroll taxes paid directly by the Company. Similar costs incurred by employees of Bell Atlantic Network Services, Inc. (NSI) are allocated to the Company and are included in other operating expenses. The increase in employee costs of $41.8 million or 6.1% was due primarily to increases in salary and wages. Wage increases in August 1991 and 1990 provided for in labor contracts covering associate employees, and salary progressions in April 1991 and 1990 for management employees resulted in increased costs of $15.9 million and $9.5 million, respectively. In addition, expenses related to health care benefits for both active and retired employees increased $15.3 million due to increases in health care costs. The Company continues to address the adverse effects of health care inflation by implementing certain medical cost containment initiatives in 1991 that were included in the aforementioned labor contracts. Additional cost sharing arrangements affecting management employees retiring after December 31, 1991 were also announced during 1991 in an effort to control future health care cost increases.

During 1991, the Company announced a retirement incentive program. Under the program, retirement-eligible management employees were entitled to increased pension benefits and other non-cash incentives if they retired on December 15, 1991. Approximately 560 management employees retired under this program.

Depreciation and Amortization

Depreciation and amortization expense decreased $50.3 million or 9.1% from 1990. This decrease was mainly attributable to a $66.5 million reduction in amortization expense associated with the amortization of certain assets in accordance with an FCC order. This decrease was partially offset by a 3.8% increase in depreciable plant and a $3.4 million FCC approved depreciation rate increase retroactive to January 1, 1991.

On December 19, 1991, the PUC approved the Company's petition to change the depreciable lives of certain classes of plant resulting in a net decrease to plant lives. The Company filed a petition on December 23, 1991, with the FCC requesting similar changes in depreciable lives. The FCC issued a counter proposal which further decreased plant lives. The Company accepted the counter proposal. The combined effect of the PUC and FCC awards will increase 1992 annual depreciation expense approximately $100.0 million.

Other Operating Expenses

Other operating expenses consist primarily of contracted services including centralized service expenses allocated from NSI, rent, operating taxes other than income taxes, and other general and administrative expenses. Other operating expenses increased $48.1 million or 4.6% over 1990. The expense increases resulted from a $26.7 million increase in state operating taxes mainly due to STAS, a $22.3 million restructure related charge associated with the Company's retirement incentive program, a $17.8 million increase in intercompany rent expense due to a classification change, to revenues, of a portion of the intercompany charges which had previously been reflected as a reduction of expense (See Operating Revenues), and $12.1 million of additional costs allocated to the Company by NSI, as a result of its adoption of Statement No. 106.

Excluding the items mentioned in the preceding paragraph, other operating expenses decreased $30.8 million mainly due to the Company's cost containment efforts designed to mitigate the weakened economy's business volume impact and the timing of expenditures for central office switching software.

OPERATING INCOME TAXES

Operating income taxes decreased $14.1 million or 6.6% from 1990. Federal income taxes decreased $8.0 million primarily due to lower pre-tax income. The remainder of the decrease resulted from revised federal income tax estimates and the impact of the state tax rate increases enacted during 1991. State income taxes decreased $6.1 million from the comparable period in 1990. The decrease in state income taxes resulted from adjustments to align the income tax provision with actual taxes paid. These decreases were offset by the aforementioned state tax increase, which increased Corporate income tax rates from 8.5% to 12.25% resulting in increased taxes of $17.6 million. The effective income tax rate for 1991 was 34.4%, compared to 35.8% for 1990. A reconciliation of the federal statutory rate to these effective rates is included in Note 5 of Notes to Financial Statements. A discussion of the prospective impact of Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes," also is included therein.

INTEREST EXPENSE

Interest expense increased $4.4 million or 3.0% from 1990. The $4.4 million increase resulted from a $7.2 million increase in interest on long-term debt due to higher average debt levels and a $1.9 million reduction of accrued interest in 1990 associated with adjustments to estimates of access revenue liabilities. These increases were offset by a $4.7 million decrease in interest on short-term borrowings due to lower interest rates.

FEDERAL REGULATORY DEVELOPMENTS

In June 1991, the FCC released a Notice of Proposed Rulemaking (NPRM) which proposes to allow third parties to collocate their equipment in, or very near, telephone company central offices to provide special access (private line) services to the public. The FCC's stated purpose for the proposed rulemaking is to encourage greater competition in the provision of interstate special access services. The FCC has tentatively concluded that collocating parties would pay the telephone company an interconnection charge that is lower than the existing tariffed rates for similar non-collocated services. In the same release, the FCC issued a Notice of Inquiry (NOI) asking what policies it should adopt in regard to interstate switched access collocation. Comments and replies to the NPRM and NOI have been filed by Bell Atlantic and others. The FCC has not reached a final decision in either part of the proceeding, nor can the Company predict when such a decision will be made.

If the FCC permits increased competition by allowing collocation, the revenues of the Company would be adversely affected, although some of the lost revenues could be offset by increased demand if, as the local exchange carriers requested in their comments, the FCC provides them with greater pricing flexibility. Collocation for the provision of switched access services would result in greater revenue losses to the Company than would special access collocation. The Company will not be able to estimate the revenue impact of either type of collocation until the conditions of collocation (if any) are determined and announced by the FCC.

FINANCIAL CONDITION

During 1991, the Company generated $561.8 million in cash from operating activities, net of dividends, compared to $571.8 million in 1990. In 1991, the Company invested $624.1 million (net of reused material and allowance for funds used during construction) in continued expansion and technological improvements to the network, compared to $626.4 million in 1990. Management estimates that 1992 gross capital expenditures will approximate $660 million.

At December 31, 1991, the debt ratio of the Company was 47.3% compared to 42.7% at December 31, 1990. The debt ratio was significantly impacted by the equity reduction associated with the adoption of Statement No. 106. Excluding the effect of Statement No. 106, the Company's debt ratio was 42.9% at December 31, 1991.

On January 15, 1991, the Company redeemed its entire $125.0 million of 9.00% debentures, which were due in 1998, at a redemption price of 100% of their principal amount, plus accrued interest.

On August 15, 1991, the Company sold $125.0 million of 40 year 8 3/4% debentures through a public offering. The debentures are not redeemable prior to maturity. The net proceeds from the sale were used to reduce short-term debt and for the construction, expansion and improvement of the Company's telephone plant and facilities.

On November 1, 1991, the Company filed a shelf registration with the Securities and Exchange Commission for the issuance of up to $300.0 million of debt securities.

Management believes that working capital and available credit facilities are adequate to meet normal operating requirements, and that while presently foreseeable capital requirements will continue to be financed primarily through internally generated funds, some additional long-term financing may be needed to maintain the Company's capital structure within management's guidelines.

Other Matters

The Company has been designated a potentially responsible party by the U.S. Environmental Protection Agency in connection with a Superfund site. Designation as a potentially responsible party subjects the named company to potential joint liability for remediation and response costs relating to cleanup of the affected sites. Although the amount of any such cleanup costs, and the Company's share thereof, cannot be quantified at this time, management believes that the amount of its potential liability would not have a material effect on the Company's financial condition or results of operations.

Item 8. Financial Statements and Supplementary Data.

The information required by this Item is set forth on pages F-1 through F-28.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.

None.

PART III

Item 10. Directors and Executive Officers of Registrant. (Omitted pursuant to General Instruction J(2).)

Item 11. Executive Compensation. (Omitted pursuant to General Instruction J(2).)

Item 12. Security Ownership of Certain Beneficial Owners and Management. (Omitted pursuant to General Instruction J(2).)

Item 13. Certain Relationships and Related Transactions. (Omitted pursuant to General Instruction J(2).)

PART IV

Item 14. Exhibits, Financial Statement Schedules, and Reports on Form 8-K.

(a) Documents filed as a part of the report:

(1) Financial Statements:

See Index to Financial Statements and Financial Statement Schedules appearing on Page F-1.

(2) Financial Statement Schedules:

See Index to Financial Statements and Financial Statement Schedules appearing on Page F-1.

(3) Exhibits

Exhibits identified in parentheses below, on file with the Securities and Exchange Commission (SEC), are incorporated herein by reference as exhibits hereto.

Exhibit Number (Referenced to Item 601 of Regulation S-K)

3a Articles of Incorporation of the registrant as amended and restated June 15, 1987. (Exhibit 3a to The Bell Telephone Company of Pennsylvania Form 10-K for the year ended December 31, 1987, File No. 1-6393)

3b By-Laws of the registrant, as amended January 1, 1990. (Exhibit 3b to The Bell Telephone Company of Pennsylvania Form 10-K for the year ended December 31, 1989, File No. 1-6393)

4 No instrument which defines the rights of holders of long-term debt of the registrant is filed herewith pursuant to Regulation S-K, Item 601(b)(4)(iii)(A). Pursuant to this regulation, the registrant hereby agrees to furnish a copy of any such instrument to the SEC upon request.

10 Material Contracts

10a Agreement Concerning Contingent Liabilities, Tax Matters and Termination of Certain Agreements among AT&T, Bell Atlantic, the Bell Atlantic telephone subsidiaries, and certain other parties, dated as of November 1, 1983. (Exhibit 10h to Bell Atlantic Corporation's Annual Report on Form 10-K for the year ended December 31, 1983, referred to hereafter as "Bell Atlantic 1983 Form 10-K".)

10b Agreement among Bell Atlantic Network Services, Inc. and the telephone subsidiaries, dated November 7, 1983. (Exhibit 10i to Bell Atlantic 1983 Form 10-K.)

24 Consent of Coopers & Lybrand.

25 Powers of Attorney.

(b) Reports on Form 8-K

A report on Form 8-K, dated August 12, 1991, was filed reporting on Item 7 (Financial Statements and Exhibits) in connection with the sale of debt securities.

[illegible] Form 8-K, dated January 14, 1992, was filed [illegible] on Item 5 (Other Events) and Item 7 (Financial Statements and Exhibits) in connection with the adoption of Statement of Financial Accounting Standards No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions".

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

THE BELL TELEPHONE COMPANY OF PENNSYLVANIA

By /s/ William Harral
William Harral
Vice President - External Affairs and Chief Financial Officer

March 26, 1992

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the date indicated.

Principal Executive Officer:

Robert M. Valentini
President and Chief Executive Officer

Principal Financial Officer:

William Harral
Vice President - External Affairs and Chief Financial Officer

Principal Accounting Officer:

Edwin F. Hall
Controller and Treasurer

Directors:

William W. Adams
James M. Ballengee
Peter A. Benoliel
Ronald R. Davenport
Merle E. Gilliand
Mark J. Mathis
Mary Patterson McPherson
Joseph Neubauer
David S. Shapira
Ethan A. Stenger
D. Michael Stroud
Robert M. Valentini

By /s/ William Harral
William Harral
(individually and as attorney-in-fact)

March 26, 1992

THE BELL TELEPHONE COMPANY OF PENNSYLVANIA

INDEX TO THE FINANCIAL STATEMENTS AND FINANCIAL STATEMENT SCHEDULES

Financial statement schedules other than those listed above have been omitted either because the required information is contained in the financial statements and the notes thereto, or because such schedules are not required or applicable.

THE BELL TELEPHONE COMPANY OF PENNSYLVANIA

REPORT OF MANAGEMENT

The management of The Bell Telephone Company of Pennsylvania is responsible for the financial statements and the information and representations contained in this report. Management believes that the financial statements have been prepared in conformity with generally accepted accounting principles and that the information in this report is consistent with those statements. Management is required to include in the financial statements amounts, primarily related to matters not concluded by year-end, which are based on management's best estimates and judgments.

In meeting its responsibility for the financial statements of the Company, management maintains a strong internal control structure, including the appropriate control environment, accounting systems and control procedures. The internal control structure is designed to provide reasonable assurance that assets are safeguarded from unauthorized use or disposition, that transactions are properly recorded and executed in accordance with management's authorization and that the financial records permit the preparation of reliable financial statements. There is, however, inherent limitations that should be recognized in considering the assurances provided by the internal control structure. The concept of reasonable assurance recognizes that the costs of the internal accounting control structure should not exceed the benefits to be derived. The internal control structure is reviewed and evaluated on a regular basis. Compliance is monitored by the internal auditors through an annual plan of internal audits.

The Board of Directors pursues its review and oversight role for these financial statements through an Audit Committee composed of three outside directors. The Audit Committee's duties include recommending to the Board of Directors the appointment of an independent accounting firm to audit the financial statements of the Company. The Audit Committee meets periodically, with management and the Board of Directors. It also meets with representatives of the internal and independent auditors and reviews the work of each to ensure that their respective responsibilities are being carried out and to discuss related matters. Both the internal and independent auditors have direct access to the Audit Committee.

The Company's financial statements have been audited by Coopers & Lybrand, independent accountants, whose report is included on the following page.

/s/ William Harral

William Harral
Vice President - External Affairs
and Chief Financial Officer

REPORT OF INDEPENDENT ACCOUNTANTS

TO THE BOARD OF DIRECTORS AND SHAREOWNER
OF THE BELL TELEPHONE COMPANY OF PENNSYLVANIA

We have audited the financial statements and financial statement schedules of The Bell Telephone Company of Pennsylvania as listed in the index on page F-1 of this Form 10-K. These financial statements and financial statement schedules are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and financial statement schedules based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of The Bell Telephone Company of Pennsylvania as of December 31, 1991 and 1990, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 1991, in conformity with generally accepted accounting principles. In addition, in our opinion, the financial statement schedules referred to above, when considered in relation to the basic financial statements taken as a whole, present fairly, in all material respects, the information required to be included therein.

As discussed in Notes 1 and 6 to the financial statements, the Company changed its method of accounting for postretirement benefits other than pensions in 1991.

/s/ Coopers & Lybrand

2400 Eleven Penn Center
Philadelphia, Pennsylvania
February 5, 1992

THE BELL TELEPHONE COMPANY OF PENNSYLVANIA
STATEMENTS OF INCOME AND REINVESTED EARNINGS
FOR THE YEARS ENDED DECEMBER 31,

(Dollars in Millions)

	1991	1990	1989
OPERATING REVENUES			
Local service	$1,316.5	$1,287.7	$1,217.3
Network access	759.0	806.0	722.7
Toll service	474.3	463.4	452.9
Directory advertising and other	524.6	487.8	459.8
Provision for uncollectibles	(36.9)	(33.7)	(35.9)
	3,037.5	3,011.2	2,816.8
OPERATING EXPENSES			
Employee costs, including benefits and taxes	729.7	687.9	777.4
Depreciation and amortization	500.7	551.0	522.3
Other	1,083.2	1,035.1	941.7
	2,313.6	2,274.0	2,241.4
NET OPERATING REVENUES	723.9	737.2	575.4
OPERATING INCOME TAXES			
Federal	153.6	161.6	110.5
State	44.9	51.0	13.1
	198.5	212.6	123.6
OPERATING INCOME	525.4	524.6	451.8
OTHER INCOME (EXPENSE)			
Allowance for funds used during construction	1.3	3.0	2.8
Miscellaneous - net	(2.3)	(3.6)	(2.5)
	(1.0)	(.6)	.3
INTEREST EXPENSE	151.1	146.7	145.3
INCOME BEFORE CUMULATIVE EFFECT OF A CHANGE IN ACCOUNTING PRINCIPLE	373.3	377.3	306.8
CUMULATIVE EFFECT OF A CHANGE IN ACCOUNTING PRINCIPLE			
Transition [redacted] change in accounting for postretirement ben[redacted]pensions, net of [redacted] million	(397.3)	---	---
NET INCOME (LOSS)	$ (24.0)	$ 377.3	$ 306.8
REINVESTED EARNINGS			
At beginning of year	$ 792.2	$ 689.7	$ 674.5
Add: net income (loss)	(24.0)	377.3	306.8
	768.2	1,067.0	981.3
Deduct: dividends	301.1	274.8	291.5
other changes	.3	---	.1
At end of year	$ 466.8	$ 792.2	$ 689.7

The accompanying notes are an integral part of these financial statements.